

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the Matter of:

|                                  |   |               |
|----------------------------------|---|---------------|
| APPLICATION OF SOUTH CUMBERLAND  | ) |               |
| WATER DISTRICT FOR RATE INCREASE | ) |               |
| PURSUANT TO ALTERNATIVE RATE     | ) | CASE NO. 8672 |
| ADJUSTMENT PROCEDURE FOR SMALL   | ) |               |
| UTILITIES                        | ) |               |

O R D E R

On October 5, 1982, South Cumberland Water District ("South Cumberland") filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). In the application South Cumberland requested an increase of \$5,720 in annual revenue. The proposed rates actually would produce additional revenue of \$14,764 annually, an increase of 24 percent. Based on the determination herein, the revenue of South Cumberland will increase by \$13,213 annually, an increase of 21 percent.

A hearing was not requested in this matter and in accordance with the provisions of the ARF no hearing was conducted. Therefore, the decision of the Commission is based on information contained in the application, written submissions, and the annual reports and other documents on file in the Commission's offices.

#### COMMENTARY

South Cumberland is a nonprofit water distribution system organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 473 customers in Cumberland County. South Cumberland's supplier of water is the City of Burkesville ("Burkesville").

#### TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. Therefore, the financial data from the 1981 annual report is used as the basis for determining South Cumberland's revenue requirements. South Cumberland proposed no specific adjustments to the test period operating statement but made general statements in its application concerning increases in expenses. In accordance with the Commission's normal rate-making policies, the following adjustments have been made to South Cumberland's test period operating statement to reflect actual and anticipated operating conditions:

### Operating Revenue

The 1981 annual report reflected revenue from water sales of \$65,370. Upon examination of the billing analysis it was determined that actual revenue produced from the sale of water was \$56,371. South Cumberland submitted a letter on April 27, 1983, which reflected that tap-on fees in the amount of \$6,615 had been included in the revenue amount listed in the annual report. Revenue obtained from customers in the form of tap-on fees is not considered operating revenue in accordance with the Uniform System of Accounts. Therefore, the Commission has excluded the \$6,615 from revenue for rate-making purposes.

During 1981 South Cumberland increased the number of customers served by 135. The Commission has made adjustments to expenses to reflect the additional costs associated with providing service to these customers, therefore, an adjustment should be made to reflect the additional revenue that will be produced from additional sales. The Commission has increased test year revenue by \$5,516 to reflect the amount of revenue produced by the current rates based on the number of customers at the end of the test period, which results in adjusted operating revenue of \$61,887.

### Operation Labor

The 1981 annual report reflected an expense for operation labor of \$17,161. In response to an information request South Cumberland filed a Breakdown of Operation Labor, Account 600, which included invoices from Burkenville

for performing monthly billing and meter reading. South Cumberland also provided the calculations used in determining the payment to be made to Burkesville for performing these services. The compensation paid to Burkesville during the test year was based on a rate of \$85 per month and \$.50 per bill rendered and \$.50 per meter read per month plus any miscellaneous expenses. In order to reflect the current cost of these services the Commission has calculated the annual cost based on 473 current customers and meter reading by South Cumberland. This results in an annual expense of \$3,934, which is \$1,560 less than the actual test year expense. Although this is a proper operating expense it has been improperly assigned and should be charged to Account 902, Accounting and Collecting Labor.

The breakdown of Account 600 also listed \$360 of expenses paid to Burkesville for taking samples of South Cumberland's water for regulatory agencies. This expense is also improperly classified and should have been charged to Account 630, Operation Labor.

The breakdown of Account 600 also reflects that expenses of \$3,137 for work performed in the installation of new lines were improperly included therein. In accordance with the Uniform System of Accounts for Class C Water Utilities, South Cumberland should capitalize all costs of construction. Therefore, the Commission has excluded this as an expense for rate-making purposes herein.

The cumulative effect of these adjustments is to decrease the test period operation labor expense by \$10,142.

Purchased Water

The Commission has determined that South Cumberland's purchased water costs should be increased by \$8,029 to reflect the increased cost of purchased water from Burkesville, effective July 1, 1982.

South Cumberland's 1981 annual report shows that line loss for this period was 30 percent. The Commission has an established policy for rate-making purposes of disallowing the cost associated with line loss in excess of 15 percent. In a prior rate case, Case No. 7132, South Cumberland was reprimanded for its excessive line loss and was instructed to maintain a program of leak detection and correction until line loss had been reduced to 15 percent. In the Order of November 11, 1982, the Commission also ordered South Cumberland to submit monthly reports stating the quantity of water purchased, the quantity of water sold and the quantity unaccounted for until line loss for the utility had been reduced to 15 percent. As to this date no reports have been submitted by South Cumberland. In an information request in this matter, South Cumberland was given the opportunity to present evidence on the excessive line loss. However, South Cumberland failed to present any data in support of its excessive line loss other than stating that its line loss would not be as great if the water lost by the monthly flushing of lines and the amount used by the fire department

were considered. No usage amounts were provided by South Cumberland to account for the effect of these two factors on the reported line loss. Therefore the Commission has made an adjustment of \$4,356 to exclude the cost associated with the line loss in excess of 15 percent.

The cumulative effect of these adjustments is to increase the test period purchased water expense by \$3,934.

#### Operation Supplies and Expenses

The 1981 annual report reflected an expense of \$7,311 for operation supplies and expenses. In response to an information request South Cumberland stated that the total amount of the expenses included in Operation Supplies and Expenses, Account 641, should have been capitalized. Therefore, the test period operation supplies and expenses has been decreased by \$7,311 for rate-making purposes.

#### Office Supplies and Other Expenses

The 1981 annual report reflected an expense for office supplies and other expenses of \$7,216. In response to an information request South Cumberland filed a breakdown of Office Supplies and Other Expenses, Account 921, which listed invoices totaling \$7,374. Included therein were the utility bills from Tri-County Electric Membership Corporation ("Tri-County EMC") for electric service provided in 1981 totaling \$4,768. Although this is a proper operating expense it has been improperly assigned and should be placed in Fuel or Power Purchased, Account 622. This breakdown of Account 921 listed \$24 as an expense for testing performed by the

Department of Natural Resources. This expense is also improperly assigned and should have been classified as Operation Supplies and Expenses, Account 632.

Also included in the breakdown of Account 921 were expenses of \$295 for regulators, tubing and service saddles which are materials used in the installation of new service connections. In accordance with the Uniform System of Accounts for Class C Water Utilities, South Cumberland should be capitalizing all costs of construction. Other invoices totaling \$541 included within this breakdown were for items used in repairs such as tees, reducers, nuts, and bolts. These costs are also proper operating expenses but have been improperly assigned and should have been charged to Account 641, Operation Supplies and Expenses.

The net effect of these adjustments on office supplies and other expenses is a pro forma expense of \$1,746.

#### Outside Services Employed

In response to an information request South Cumberland stated that the cost it incurred to have the 1981 financial data audited and compiled in the annual report to the Commission was \$1,500. The expense incurred during the test year was \$1,050. Therefore, the Commission has increased this expense by \$450 to reflect the current costs of this service.

#### Depreciation Expense

South Cumberland reported actual depreciation expense for the test year of \$26,832. The Commission finds that

depreciation expense should be computed for rate-making purposes on the basis of the original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that contributions paid to a utility for installation of meters or any other capital expenditure have the effect of reducing the utility's capital requirements. The portion of the plant paid for by these contributions has been provided to South Cumberland free of cost and, therefore, it has nothing to recover by depreciating the donated property and should not expect its ratepayers to provide this recovery.

The record herein reflects that the level of contributions in aid of construction at the end of the test period was \$718,578 which is approximately 69 percent of the total cost of utility plant in service. Therefore, the Commission has reduced depreciation expense by \$17,965 to exclude depreciation on plant paid for with contributions in aid of construction.

#### Purchased Power Cost

South Cumberland incurred purchased power cost of \$4,768 in 1981. This expense was improperly assigned to Account 921, Office Supplies and Other Expenses, and should have been placed in Fuel or Power Purchased, Account 622. The Commission has increased this expense by \$1,014 to reflect the annual cost of electricity based on the current rates of Tri-County EMC. In determining the adjustment, the Commission has used the actual volume of electricity



purchased during the test year and applied the rates of Tri-County EMC in effect in January 1983.

### Interest Expense

Interest expense has been reduced by \$150 to reflect the annual interest expense on long-term debt outstanding at the end of the test period.

After consideration of the aforementioned adjustments the Commission finds that South Cumberland's test period operations are as follows:

|                            | <u>Actual<br/>Test Period</u> | <u>Pro Forma<br/>Adjustments</u> | <u>Adjusted<br/>Test Year</u> |
|----------------------------|-------------------------------|----------------------------------|-------------------------------|
| Operating Revenue          | \$ 65,370                     | \$ <3,483>                       | \$ 61,887                     |
| Operating Expense          | 77,901                        | <26,123>                         | 51,778                        |
| Operating Income           | \$<12,531>                    | \$ 22,640                        | \$ 10,109                     |
| Interest Income            | 1,998                         | 0                                | 1,998                         |
| Interest on Long-Term Debt | 19,250                        | < 150>                           | 19,100                        |
| Net Income                 | <u>\$&lt;29,783&gt;</u>       | <u>\$ 22,790</u>                 | <u>\$&lt; 6,993&gt;</u>       |

### REVENUE REQUIREMENTS

South Cumberland's annual debt service requirement is \$21,100. The adjusted test period operating statement reflects a net loss of \$6,993 which provides no coverage on South Cumberland's debt service. The Commission is of the opinion that the adjusted operating loss will adversely affect the financial condition of South Cumberland. To improve South Cumberland's debt service coverage to a reasonable level of 1.2, additional revenues of \$13,213 are required. Based on adjusted test period results, total operating revenues of \$75,100 will produce net operating income of \$23,322, which after considering interest income of

\$1,998 will be sufficient to allow South Cumberland to pay its operating expenses and meet its debt service requirements.

The Commission has made adjustments to reflect a normal level of revenue and expenses for rate-making purposes. Some of the adjustments were necessary because South Cumberland failed to follow accounting practices prescribed by the Uniform System of Accounts for Class C Water Utilities as adopted by this Commission. Rate proceedings filed under the ARF require that the utility maintain adequate financial records and that the annual reports be reasonably accurate. Therefore, in the future South Cumberland should be aware of this requirement and maintain accurate and complete records in order to comply with the regulations established by this Commission.

When a utility finds it necessary to obtain the assistance of professionals, the Commission expects the utility to secure the services of professionals who are familiar with Commission regulations and utility operations and accounting requirements to assure that maximum benefit is derived from the money paid for these services. It is the responsibility of the utility to monitor the professionals it chooses to evaluate the adequacy of the services being provided.

#### OTHER ISSUES

This agency is charged by statute with the responsibility of seeing that safe and adequate service is

provided to the customers served by the public utilities in this state. Therefore, the Commission is concerned with South Cumberland's failure to comply with the Order in Case No. 7132, dated November 11, 1980, which required the establishment of a leak detection and correction program. This program is necessary in order for South Cumberland to provide adequate service to its customers.

The Commission wishes to apprise South Cumberland of the seriousness of its non-compliance with lawful Orders, and furthermore that, as a result of this non-compliance, it is subject to the imposition of penalties under Kentucky Revised Statutes 278.990.

In order to avoid the imposition of such penalties, South Cumberland should take immediate action to accomplish the leak detection and correction program specified in the Order in Case No. 7132 and should report said action to the Commission within 30 days of the date of this Order.

#### RATE DESIGN

South Cumberland did not propose to alter its rate design but to increase the present rate structure to provide the requested revenue. After repeated requests, South Cumberland failed to provide an accurate and useful billing analysis, but it did provide the actual usage records for the test year. These records were used by staff to construct the billing analysis used to develop the revenue requirement and rates contained in this Order.

The 5/8 x 3/4 inch and 3/4 inch meter blocks were combined to reflect the similarities in meter types. This will have no effect on revenue because there are no customers in the 3/4 inch meter blocks.

#### SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are fair, just and reasonable rates for South Cumberland in that they will produce annual revenues of approximately \$75,100 and should be approved. This revenue will be sufficient to meet South Cumberland's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

2. The rates proposed by South Cumberland would produce revenue in excess of that found reasonable herein and should be denied.

3. The record herein demonstrates that South Cumberland's 1981 annual report contains deficiencies that should be corrected to be in conformity with Commission regulations.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by South Cumberland on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by South Cumberland be and they hereby are denied.

IT IS FURTHER ORDERED that South Cumberland shall, within 30 days of the date of this Order, comply with the Order in Case No. 7132.

IT IS FURTHER ORDERED that within 30 days from the date of this Order South Cumberland shall file with this Commission its revised tariff sheets setting out the rates approved herein.

IT IS FURTHER ORDERED that South Cumberland shall revise its 1981 annual report in conformity with accounting practices as prescribed by the Uniform System of Accounts for Class C Water Utilities as adopted by this Commission.

Done at Frankfort, Kentucky, this 16th day of May, 1983.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

\_\_\_\_\_  
Secretary

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8672 DATED MAY 16, 1983

The following rates and charges are prescribed for the customers in the area served by South Cumberland Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

#### WATER RATES

##### 5/8 X 3/4 Inch and 3/4 Inch Meters

|          |                              |                  |
|----------|------------------------------|------------------|
| First    | 2,000 Gallons (Minimum Bill) | \$9.50 Per Month |
| Next     | 3,000 Gallons                | 3.50 Per 1,000   |
| Next     | 5,000 Gallons                | 2.55 Per 1,000   |
| All Over | 10,000 Gallons               | 1.60 Per 1,000   |

##### 1 Inch Meter

|          |                              |                   |
|----------|------------------------------|-------------------|
| First    | 5,000 Gallons (Minimum Bill) | \$20.00 Per Month |
| Next     | 5,000 Gallons                | 2.55 Per 1,000    |
| All Over | 10,000 Gallons               | 1.60 Per 1,000    |

##### 1-1/2 Inch Meter

|          |                               |                   |
|----------|-------------------------------|-------------------|
| First    | 12,500 Gallons (Minimum Bill) | \$50.00 Per Month |
| All Over | 12,500 Gallons                | 1.60 Per 1,000    |

##### 2 Inch Meter

|          |                               |                    |
|----------|-------------------------------|--------------------|
| First    | 25,000 Gallons (Minimum Bill) | \$100.00 Per Month |
| All Over | 25,000 Gallons                | 1.60 Per 1,000     |

SERVICE CONNECTION CHARGES

|                      |                             |
|----------------------|-----------------------------|
| 5/8 X 3/4 Inch Meter | \$300                       |
| 3/4 Inch Meter       | 300                         |
| 1 Inch Meter         | 375                         |
| 1-1/2 Inch Meter     | 735                         |
| 2 Inch and Larger    |                             |
|                      | Actual Cost of Installation |